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Is the Death of the Paper Cheque Upon Us?: The Electronic Presentment and Deposit of Cheques in Canada

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RECENT DEVELOPMENTS

Is the Death of the Paper Cheque Upon Us? The Electronic Presentment and Deposit of Cheques in Canada

Benjamin Geva*

1. INTRODUCTION: THE ELECTRONIFICATION OF THE CHEQUE TRANSACTION — AN OVERVIEW

A cheque is an unconditional written order addressed to a bank ("drawee"),¹ signed by the person giving the order ("drawer"), requiring the drawee bank to pay, on demand, a sum certain in money to or to the order of a specified person ("payee") or to bearer.² The person to whom a cheque is payable who is in the possession of the cheque is its holder.³ The latter is either the original payee or bearer or a transferee by negotiation.⁴ Payment of the cheque is upon its presentment.⁵ However, typically, a holder will not present the cheque to the drawee bank in person. Rather, the holder is likely to have the cheque deposited with and collected by a depositary bank, with which the holder maintains an account. Where both banks are direct clearers,⁶ the depositary bank will present the cheque to the drawee bank.

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¹ In the footsteps of s. 164 of the Canadian *Bills of Exchange Act* ("BEA"), R.S.C. 1985, c B-4. "bank" is used in this commentary to include any member of the Canadian Payments Association [CPA]. CPA membership includes the Bank of Canada, federally chartered banks and authorized foreign banks as well as regulated deposit taking and other regulated financial intermediaries providing payment services which meet specified requirements. *Canadian Payments Act* [CP Act], R.S.C. 1985, c. C-21, s. 4.

² BEA, *ibid.* ss. 165(1), 17(1).

³ *Ibid.* s. 2.

⁴ Negotiation is the transfer from one person to another in such a manner as to constitute the transferee the holder. See BEA, *ibid.* s. 59.

⁵ The principal drawer's undertaking under BEA s. 129(a), is "that on due presentment [the instrument] shall be accepted and paid according to its tenor." Presentment requirements are set out in BEA, *ibid.* s. 84.

⁶ That is, a CPA member maintaining a settlement account (as well as establishing a loan facility) with the Bank of Canada, and meeting other requirements. See Canadian Pay-

The normal process thus entails a series of physical deliveries⁷ of the piece of paper embodying the cheque. First, the cheque is physically issued by the drawer to the first holder.⁸ Second, there may be one or more physical transfers by negotiation outside the banking system.⁹ Third, there is the delivery of the cheque by the holder to the depository bank.¹⁰ Fourth, where the drawee and/or depository bank are not direct clearers, there may be one or more deliveries of the cheque to intermediary bank(s). Fifth, the process concludes with a physical presentment of the cheque to the drawee.¹¹ By statute, presentment is usually to take place at the branch on where the drawer's account is maintained.¹² Following payment, there is possibly a sixth and post-concluding stage, in which the cancelled cheque is delivered by the drawee bank to the drawer, together with the periodic statement containing it. Conversely, where the drawee dishonours the cheque, the cheque is returned to the depositor in a reversed itinerary.

Over the years, banks have been introducing automation to their own respective cheque collection procedures. Particularly, interbank facilities and large institutions have developed automated systems using cutting age technology in which very little is done manually and at the branch level. Rather, in the framework of such a system, the collection of cheques is mostly carried out in regional data centers as well as by third-party processors. The system has facilitated the efficient, fast collection and payment. It has also enabled the return of a large volume of dishonoured cheques. It accomplished this while satisfying customers' needs and at the same time remaining safe and secure. However, automation has not dispensed with the physical handling of the cheques. It expedited calculations and adjustment of balances and even increased speed. Yet, it has not eliminated the physical movement of paper. Physical movement remained indispensable in order to satisfy statutory requirements for issue, negotiation, and presentment, as discussed above.¹³ Indeed, in Canada, CP Act¹⁴ s. 29 provides that "Members may present payment items and shall accept and arrange for settlement of payment items in accordance

ments Association By-law No. 3 — *Payment Items and Automated Clearing Settlement System* S.O.R./2003-346, s. 26.

⁷ "Delivery" is defined in BEA, *supra* note 1, s. 2, as the "transfer of possession, actual or constructive, from one person to another."

⁸ See *ibid.* ("issue" defined).

⁹ See *ibid.* ss. 2, 59 ("endorsement" defined).

¹⁰ Throughout this commentary I am adopting the American term, "Depository bank", defined in UCC 4-105(2), to effectively mean the bank in which the customer deposits the cheque for collection.

¹¹ Cf. BEA, *supra* note 1, s. 84(3) (exhibition by the holder to the drawee).

¹² See *ibid.* s. 87. Particularly subs. (b).

¹³ *Barclays Bank, plc v. Bank of England*, WL 310598, [1985] 1 All ER 385, Bingham J. For an overview see Benjamin Geva, "Is Canada Ready for the Paperless Cheque?: An Analysis of the Historical and Practical Implications of Going Paperless" (August 2012) 31 Nat'l Banking L. Rev 49.

¹⁴ *Supra* note 1.

with the by-laws and the rules" promulgated by the CPA.¹⁵ Nonetheless, the reach of that provision, particularly to eliminate the physical presentment of a cheque, in variation of statutory requirements, as well as of rights of parties who are not CPA members,¹⁶ particularly between themselves, has not been settled.¹⁷

Modern banking practice has not been able to live within these constraints and has made variations. First, a cheque may be given as a source of information to be used to initiate a one-time electronic fund transfer. Second, a cheque may be created remotely. Theoretically, one can then think of an electronic negotiation from one person to another outside the cheque collection system. I am not aware of the existence of such practice. However, third, a cheque may be deposited by means of electronic transmission.¹⁸ Fourth, a cheque may be forwarded electronically by one collecting bank to another.¹⁹ Fifth, a cheque may be presented for payment electronically. Sixth, a functional equivalent to a cheque may be created exclusively

¹⁵ The CPA's power to make by-laws and rules "for the attainment of the objects of the Association" is provided for in CP Act *supra* note 1, ss. 18, 19 respectively.

¹⁶ I am not suggesting that customers are necessarily worse off if presentment rules are modified. Nor do I overlook the argument that benefits conferred on banks acting as agents for collection may be passed to their principals/customers per *Riedell v. Commercial Bank of Australia*, [1931] V.L.R. 382. At the same time, currently, the prevailing view in Canada (at least among Ontario courts) is that clearing by-laws and rules neither bind nor benefit bank customers. See e.g. *National Slag v. Canadian Imperial Bank of Commerce*, 1982 CarswellOnt 1333, 140 D.L.R. (3d) 473, [1982] O.J. No. 3686 (Ont. H.C.); affirmed 1985 CarswellOnt 1734, 19 D.L.R. (4th) 383, [1985] O.J. No. 149 (Ont. C.A.) and *Advance Bank v. Toronto Dominion Bank*, 2003 CarswellOnt 1927, 65 O.R. (3d) 46, 35 B.L.R. (3d) 266, 227 D.L.R. (4th) 755, [2003] O.J. No. 2027 (Ont. S.C.J.).

¹⁷ I read Crawford to say that under this provision the CPA may make by-laws and rules that vary rights and obligations (even of non-members of the CPA) under the BEA. See Bradley Crawford, *The Law of Banking and Payment in Canada*, loose-leaf (Toronto: Carswell, updated to 2013) at §11:50.30(2). (See also *ibid.* at §11:50.20 where he argues that CP Act s. 29 is to be read as conferring rights on customers.) But if so, why were the BEA electronic presentment provisions, discussed below in Part 2, enacted? It appears to me that other than in the framework of the image rule project implementing these provisions the CPA itself has not purported to override BEA presentment requirements. See CPA, *Proposed Framework to Support Phase IV of the Image Rule Project Electronic Clearing Exchange* (Consultation Document January 2013), IV. *Proposed Framework for Electronic Clearing Exchange, under E. What constitutes Presentment*. online: <http://www.cdnpay.ca/imis15/eng/Publications/News/eng/res/ns/consultation_document_phase_iv_image_rule.aspx>. It is conceded there by the CPA that "presentment for paper items is defined in the [BEA]" and hence does not require definition in a CPA Rule. Finally, even if the by-law becomes part of the contract between each bank and its customer, how does it become a term in the contract between the two customers?

¹⁸ Inasmuch as a deposit involves a delivery, albeit not necessarily with an endorsement (BEA s. 165(3) discussed further at the end of Part 3 below), it is at least sufficiently close to "negotiation" to be discussed in that context.

¹⁹ "Collecting bank" is defined in UCC 4-105(5) to mean any "bank handling an item for collection except the [drawee] bank." This American term is widely used also in the

electronically; such a cheque has been described as an "electronic payment order" (EPO).

A cheque may be given by a payer to the payee with the authority to use the cheque information to initiate an electronic debit transfer from the payer's account. No cheque is "issued", since its first delivery by the payer is as a source of information to be used by the payee for the initiation of a debit transfer; the "first delivery" is not "to a person who takes [the cheque] as a holder", expecting to collect and/or enforce it, as required by BEA s. 2, for the issue of a "cheque". The ensuing debit transfer is neither originated by cheque nor processed through the cheque collection system. This practice has not been evolved in Canada.²⁰

A remotely created cheque is drawn by the payee, as an agent of the drawer, on the basis of information provided by the drawer to the payee, typically, over the telephone. However, the authorization to issue the cheque may be given to the payee also by means of electronic communication.²¹ The Canadian Payments Association ("CPA") prohibits the clearing of remotely created cheques, or "tele-cheques".²² In the absence of a pre-existing written and signed authorization by the drawer, fraud, due to the inability of the drawee bank to verify the authority of its customer, is cited as the "key risk associated with a tele-cheque."²³

In Canada, the Interac e-Transfer operates like a nationwide EPO system. It is available to subscribers of online banking services with their respective banks. The e-Transfer is initiated by an e-mail instruction given by the payer to the payer's bank over a secured Internet connection identifying the payee by an email address.

UK and Canada. The depositary bank, and where it is not the presenting bank, every intermediary bank, is a collecting bank.

²⁰ It would have been governed by CPA "Rule H1 — Pre-Authorized Debits (PADs)" *Canadian Payments Association* (2010), online: <http://www.cdnpay.ca/imis15/pdf/pdfs_rules/rule_h1.pdf>.

²¹ For a brief review of the remotely created cheque in the US and Canada, see Benjamin Geva, "Recent International Developments in the Law of Negotiable Instruments and Payment and Settlement Systems" (2007) 42 *Tex. Int'l L.J.* at 685, 690-91.

²² In fact, there is no explicit prohibition in a specific Rule. Rather, it is the CPA's Policy Statement, *infra*, that effectively prohibits tele-cheques. Rule A4, Section 6(j) outlines the return time-frame for tele-cheques which may be returned for the reason "Not Eligible for Clearing", up to and including 90 days after receipt by the Drawee. Rule A4 is available at "Rule A4 Returned and Redirected Items" *Canadian Payments Association* (2013), online: <http://www.cdnpay.ca/imis15/pdf/pdfs_rules/rule_a4.pdf>. For a critique (on the CPA's authority in the matter) see Crawford, *supra* note 17 at §6:50.70(1)(b).

²³ CPA Policy Statement, *Prohibition of Tele-cheques in the Clearing & Settlement System*, (1 June 2003), online: <http://www.cdnpay.ca/imis15/eng/Act_Rules/Automated_Clearing_Settlement_System_ACSS_Rules/eng/rul/policy_statement_telecheques.aspx>. In the US, the Federal Trade Commission recently proposed to ban the use of remotely created cheques by tele-marketers on similar grounds: See "FTC Seeks Public Comment on Proposal to Ban Payment Methods Favored in Fraudulent Telemarketing Transactions" *Federal Trade Commission* (21 May 2013), online: <<http://www.ftc.gov/news-events/press-releases/2013/05/ftc-seeks-public-comment-proposal-ban-payment-methods-favored>>.

The payer's bank debits the payer's account and advises the payee in an email message sent over an unsecured Internet connection. The payee both accesses the instruction and instructs the payee's bank via a secured Internet connection to collect the payment.²⁴ System is operated and cleared by Acxsys Corporation and participants settle either over the LVTS or bilateral netting. All major banks in Canada are participants. In a sense, the Interac email transfer may be viewed as a form of a guaranteed payment operating like a certified cheque or a bank draft. Not involving a paper check at any point, the e-mail instructions are not governed by the BEA.

2. BEA ELECTRONIC PRESENTMENT AND CPA IMAGE RULE PROJECT

Both electronic presentment and the electronic deposit have developed in Canada under a CPA's scheme implementing BEA provisions that were added with the view of enabling the electronic presentment.²⁵ As a whole, the scheme provides for a legal framework facilitating a remote image capture of a cheque, the image transmission, and possible reconversion to a replacement document. This part will examine the electronic presentment as authorized and implemented. Part 3 will address the electronic deposit practice.

Recognizing that remote presentment would expedite the collection of cheques Parliament passed in 2007 an amendment to the BEA authorizing electronic presentment of an official image of a cheque. The principal provision, Section 163.3(1), states as follows:

Despite anything in this Act, a bank may present for payment an official image of an eligible bill electronically in accordance with by-laws, rules or standards made under the *Canadian Payments Act* and, if it does so, the requirements of this Act respecting the presentment for payment of the eligible bill are deemed to have been complied with.

BEA s. 163.1 defines "eligible bill" to mean

a bill that is of a class specified by a by-law, a rule or a standard made under the *Canadian Payments Act*.

It goes on and defines "official image" to mean

an image of that eligible bill created by or on behalf of a bank in accordance with by-laws, rules or standards made under the *Canadian Payments Act*, together with any data in relation to the eligible bill prepared in accordance with those by-laws, rules and standards, and includes a display, a printout, a copy or any other output of that image and that data created by or on behalf of a bank in accordance with those by-laws, rules and standards.

It is further provided in BEA s. 163.2 that:

An official image of an eligible bill may be dealt with and used for all purposes as though it were the eligible bill.

²⁴ For service and system description see Crawford, *supra* note 17 at §16:60.30(1).

²⁵ *An Act to amend the law governing financial institutions and to provide for related consequential matters*, S.C. 2007, c. 6, s. 398.

Under BEA s. 163.6(1), a bank

that creates or purports to create an official image of an eligible bill, or on whose behalf an official image of an eligible bill is created or purported to be created, warrants that the official image or the purported official image, as the case may be, was created in accordance with by-laws, rules or standards made under the *Canadian Payments Act* and that it accurately represents the eligible bill.

Under BEA s. 163.6(2),

Any person who has suffered damages as a result of a breach of the warranty has a cause of action for damages against the bank.

Along lines envisaged in the statutory scheme, in December 2009 the CPA Board approved an image rule facilitating the electronic presentment of cheques.²⁶ The CPA launched the project consisting of four phases as follows:²⁷

1. Phase I (June 1, 2010) established requirements and technical standards governing image creation and storage.
2. Phase II (June 1, 2011) established an enabling framework for the optional creation and use of Return Replacement Documents (RRDs) e.g. upon cheque dishonour. It allowed image retrieval for the purpose of return to be completed nearly instantaneously bypassing off-site storage and retrieval costs.
3. Phase III (October 1, 2012) established an enabling flexible framework designed to speed up the forward presentment of cheques. The framework facilitated the creation and transmission of images within a bank, as well as the use of interbank agreements for the exchange of images. It is premised on the optional creation and use of Clearing Replacement Documents (CRDs). For example, within the depositary bank, images may be created in branches and ABMs and transmitted to the regional data centers serving them. In the absence of a governing bilateral agreement between the depositary and drawee for the exchange of images, the data centre of the depositary bank will convert images received by it into CRDs to be delivered to the drawee bank. Having received CRDs or images, the drawee bank may convert (and reconvert) them. It may forward, either what it received or what it converted, within its organization. For each cheque, there is no limit to the number of conversion from paper to image and vice versa. Both RRDs and CRDs are image-based fully

²⁶ "Rule A10, Image Rule" *Canadian Payments Association* (2014), online: <http://www.cdnpay.ca/imis15/pdf/pdfs_rules/rule_a10.pdf>. This has been updated with each of the phases discussed immediately below. Under its s. 2 the cheque is an "eligible bill."

²⁷ For a CPA overview dated August 12, 2013, visit: "Image Rule Project Overview" *Canadian Payments Association* (2013), online: <http://www.cdnpay.ca/imis15/eng/Publications/News/eng/res/ns/cpa_image_rule_project.aspx>. Visit also: "Proposed Framework to Support Phase IV of the Image Rule Project Electronic Clearing Exchange (Consultation Document)" *Canadian Payment Association* (January 2013), online: <http://www.cdnpay.ca/imis15/eng/Publications/News/eng/res/ns/consultation_document_phase_iv_image_rule.aspx>.

encoded documents that can be handled in the cheque clearing system as if they are original cheques.

4. Phase IV (August 12, 2013) established an Electronic Clearing Exchange (ECE) facilitating an interbank electronic exchange of images. Effectively it established industry rules and standards to support the exchange of images that was made permissible already in Phase III. This final phase of the project provides a framework that allows direct clearers to exchange electronic payment files containing image captured payments (ICPs) with a counterparty that agreed to participate in ICP Exchange. Phase IV framework also accommodates a situation where two members may have access to a shared archive or archive service by permitting a forward presentment in which a ECE file is exchanged without the corresponding image. For presentment to occur, the corresponding image must still be made available to the drawee to which the image is accessible in the archive. However, all return files must contain the corresponding image.²⁸ This is so because a depositary bank may designate another bank to receive returns. For example, small banks may have processing outsourcing arrangements with large bank, and in areas where they have no presence, even large banks may use the services of other banks.

Overall, the scheme facilitates the presentment as well as the return by a bank of an electronic image,²⁹ constituted by "a digital representation of the front and back of a Payment Item;"³⁰ the physical presentment by a bank of an "Image Printout"³¹ or a CRD;³² and the physical return of an RRD as well as of an image

²⁸ This is authorized by CPA Rule A3 (Endorsement and Identification of Paper Items) CPA, Policy Statement, *Rule A3* (February 1983), s. 6, to which Rule A4 (Returned and Redirected Items) CPA, Policy Statement, *Rule A4* (February 1983), s. 11 makes an allusion.

²⁹ In principle, under CPA Rule A10 ss. 31 and 32.

(a) An ICP Item is presented to the Drawee when an Image of the ICP Item is accessible by the Drawee.

(b) An Image of the ICP Item is accessible by the Drawee when the Drawee, or its representative, is able to make use of an Archive in which the Image of the ICP Item is stored.

³⁰ CPA Rule A10 s. 4(1) (definition of "image").

³¹ Defined in CPA Rule A10 s. 4(n) to mean "any paper output of an Image, created by a [CPA] Member".

³² Indeed, under BEA, *supra* note 1, s. 163.1 "official image" is broad enough to cover a CRD (as well as an image printout). However, being a piece of paper, the CRD (as well as the image printout) is not "electronically" presented as authorized under BEA, *supra* note 1, s. 163.3(1). However, under BEA, *supra* note 1, s. 163.2 an "official image" in all its forms is equated with the cheque and thus in its CRD as well as "Image printout" derivation may be physically presented. All relevant BEA sections are reproduced at the beginning of this part.

printout.³³ In the footsteps of the BEA, forward transmission of images and delivery of replacement documents for collection, as where the depository bank is an indirect clearer³⁴ and the deposited cheque is drawn on a drawee which is not its clearing agent,³⁵ are not addressed in the CPA project.³⁶ The theory may have been that since under BEA s. 163.2, "[a]n official image of an eligible bill may be dealt with and used for all purposes as though it were the eligible bill", no specific treatment is required. In this context it is to be noted that the warranty under BEA s. 163.6(1) as to the genuineness of the "official image" is with regards to the creation of the image — and not to its transfer or presentment.

3. REMOTE DEPOSIT UNDER CPA IMAGE RULE PROJECT

Taking advantage of this legislative scheme as implemented by the CPA, a remote-deposit (known also as "e-deposit") practice has developed. Thereunder, either a corporate or individual customer transmits a complying image to the depository bank. The practice is premised on the constructive delivery of the paper cheque by the depositor to the depository bank in the course of the electronic transmission or immediately prior to it so as to treat the depositor as creating the "official image" "on behalf of [the] bank" as required.³⁷ The official image is then used by the bank as a basis for the ultimate presentment of the cheque.³⁸ It is of course essential that what is transmitted by the customer will comply with all CPA technical requirements³⁹ as from a legal perspective this is an image created by the bank. In any event, remote deposit (as opposed to remote presentment) was not directly envis-

³³ An RRD may be returned like a cheque since under BEA s. 163.2, an "official image," under each of its derivations, "may be dealt with and used for all purposes as though it were the eligible bill." *Ibid.*

³⁴ A CPA member which is not a direct clearer (see note 6 above). An indirect clearer employs a direct clearer to take on its behalf in the exchange and clearing and settles on the books of that direct clearer.

³⁵ In that case, the depository bank may forward an image or a CRD to its clearing agent for collection and not as a presentment.

³⁶ In the United States the interbank forward collection of replacement documents ("substitute checks") is governed by *Check Clearing for the 21st Century Act* ("Check 21 Act") 12 U.S.C. §§5001 *et seq.*; 117 Stat. 1177; Pub. L. 108-100 (2003).

³⁷ For a discussion see Crawford, *supra* note 17 at §34: 25.30(4) (a) and (b). For my own skepticism, acknowledged by Crawford, *ibid.* see Benjamin Geva, "Electronic Deposit of Official Images: A reply to Bradley Crawford, QC" (October 2012), 31 Nat'l Bank-ing L. Rev., at 69.

³⁸ The practice has been acknowledged by the CPA. See announcement dated August 12, 2013 "Image Rule Project now Complete" Canadian Payments Association (2013), online: <http://www.cdnpay.ca/imis15/eng/Publications/News/eng/res/ns/image_rule_project_complete.aspx>. As well as "Image Rule Project Overview" Canadian Payments Association, online: <http://www.cdnpay.ca/imis15/eng/Publications/News/eng/res/ns/cpa_image_rule_project.aspx>.

³⁹ Specifications for image creation are provided for in CPA Rule A10, *supra* note 24, ss. 9-11.

aged by the legislation; hence, allocation of losses by its misuse was not provided for.

Remote deposit abuse may arise due to the fact that the cheque itself remains in the possession of the depositor. The latter is likely to be under an obligation neither to redeposit nor to transfer it. Nevertheless, in breach of that obligation, the depositor may either redeposit the cheque, or negotiate it to a subsequent holder, other than a bank of deposit, such as a cheque cashing service ("CCS").

A redeposit may be either remote (in which case it may be repeated several times) or physical. It may be made to the original bank of deposit or to another bank. There seems to be little doubt if any that the depositor is liable for losses caused. Provided respective banking contracts are properly drawn, towards each depository bank, the depositor's liability is likely to be in breach of contract. Towards a subsequent endorsee liability is likely to be in breach of the good title undertaking under BEA s. 132(c). Towards all parties, including with whom the depositor is not in privity, potential liability is in fraud.

Liability among banks is more intricate. In the absence of direct law on the point, the Federal Reserve Board is proposing in the US to fasten on the bank that accepted an electronic deposit a duty to indemnify (i) against double payment, "any collecting bank, the [drawee] bank, and the drawer"⁴⁰ as well as (ii) against any loss incurred to any bank that accepted a deposit of the paper cheque.⁴¹

Suppose a holder transmits a cheque image for deposit at a depository bank and subsequently negotiates the paper cheque to CCS. The chance is that as a holder in due course ("HDC") CCS will be allowed to recover from the drawer,⁴² whose account has already been debited by the drawee bank. In such a case the drawer has a remedy against the depositor. Under the above mentioned proposal of the Federal Reserve Board the drawer may have an alternative remedy against the depository bank that accepted an electronic deposit.

According to the US proposal, a drawer whose account was debited more than once due to multiple deposits will be able to sue the bank that accepted an electronic deposit. As indicated, the drawer may also sue the depositor. Will the drawer be able to recover from the drawee bank (which can then turn to the depository bank and depositor)? The drawee bank may not have caught the double presentment. It is not all that clear, whether a drawer may argue that the first payment discharged the cheque altogether or that as a matter of the banking contract multiple payment on the same cheque is to be taken as unauthorized. The broader question, as a matter of policy, is whether in an environment facilitating remote deposit capture a drawee bank is not to be obliged to protect its customers against multiple

⁴⁰ See Proposed §229.34(a) to Reg. CC 12 C.F.R. Part 229. U.S. Federal Register, "Availability of Funds and Collection of Checks" 79 Fed. Reg. 6674 (February 4, 2014) (to be codified at 12 C.F.R. pt. 229.34(a)), available online: <<https://www.federalregister.gov/articles/2014/02/04/2013-30024/availability-of-funds-and-collection-of-checks>>.

⁴¹ See Proposed §229.34(a) to 12 C.F.R. Part 229.334(g). *Ibid.*

⁴² For the HDC and his rights see BEA, *supra* note 1, ss. 55, 73(b).

deposits. *Quaere* whether such a duty is not economically onerous⁴³ and whether it can be contracted out. In practice, if the Federal Reserve Board's proposal is pursued, the drawer may be satisfied with a direct cause of action against the bank that accepted the electronic deposit. This however may not always be the case and on the level of principle the allocation of risk between the drawer and the drawee requires further attention.

Exploration of all such questions is beyond the scope of this commentary. At the same time, against such uncertainties, can the negotiability of the cheque be restricted so as at least to preclude the CCS from becoming a HDC? Three methods will be investigated: cheque crossing, cheque notation, and restrictive endorsement. All of them require permissible changes in the pre-printed cheque forms distributed to customers.

First, under BEA s. 168, a cheque bearing across its face an addition of two traverse lines, with or without the word "bank" between them, is crossed generally. A cheque bearing across its face an addition of the name of a bank is crossed specially to that bank. A cheque may be crossed either with or without the words "not negotiable." Under BEA s. 174,

Where a person takes a crossed cheque that bears on it the words "not negotiable", he does not have and is not capable of giving a better title to the cheque than the person from whom he took it had.

Stated otherwise, a cheque bearing the words "not negotiable" is transferable by "negotiation" so as to make the transferee a "holder" — but not a HDC.

However, cheque crossing has other effects⁴⁴ and is not practiced in Canada where legislation has not caught up with reform elsewhere and remained deficient.⁴⁵

Second, an attempt could be made to invoke BEA s. 20(1). Thereunder,

When a bill contains words prohibiting transfer, or indicating an intention that it should not be transferable, it is valid as between the parties thereto, but it is not negotiable.

Indeed, the cheque is "a bill drawn on a bank, payable on demand" (BEA s. 165(1)) and in principle, "the provisions of [the BEA] applicable to a bill payable on demand apply to a cheque" (BEA s. 165(2)). However, around 120 years ago, in

⁴³ Effectively, in discharging such a duty, the drawee will have to treat every cheque that was paid on the basis of an electronic presentment as if it was countermanded so as to continue to monitor its possible subsequent presentment in a paper form.

⁴⁴ Defences available to paying and collecting banks particularly by means of cheque crossing is discussed in Benjamin Geva, *Bank Collections and Payment Transaction: Comparative Legal Aspects* (Oxford: Oxford University Press, 2001) at 473–489.

⁴⁵ Elsewhere where cheque crossing is practiced the statute was amended in response to the English case *Capital and Counties Bank v. Gordon*, [1903] A.C. 240 which effectively held that having credited a depositor's account prior to presenting the cheque to the drawee, the collecting bank cannot be said to receive from the drawee "for a customer payment of a cheque" as required under the English counterpart of BEA, *supra* note 1, s. 175. For the English perspective, see AG Guest, *Chalmers and Guest on Bills of Exchange, Cheques and Promissory Notes*, 17th ed. (2009) at §17-031.

National Bank v. Silke,⁴⁶ Lindley LJ doubted that the English provision which is parallel to Canadian BEA s. 20(1) applied to cheque. He questioned whether the negotiability of a cheque can be curtailed other than by crossing. In a modern English textbook, Chalmers and Guest appear to share this doubt.⁴⁷ Crawford is however of the view that in light of the absence of crossing practice in Canada, Canadian courts may nevertheless hold BEA s. 20(1) to apply to cheques. At the same time, he adds, to do so, "Canadian courts will have to be comfortable with the knowledge that such an interpretation is an innovation."⁴⁸

To comply with BEA s. 20(1), if applicable, the cheque ought to prohibit transfer or indicate an intention that it should not be transferable.⁴⁹ Assuming the prohibited "transfer" is limited to the transfer of ownership, the provision will not preclude the depositary bank from acting as an agent for collection for the depositor.⁵⁰ Otherwise, BEA s. 20(1), applies to a bill that "contains words prohibiting transfer, or indicating an intention that it should not be transferable;" this does not seem to be broad enough to cover a bill containing words "restricting transfer" or "indicating an intention that its transfer be restricted" e.g. only to a depositary bank. True, I will not rule out the possibility that with the view of accommodating the electronic deposit, a Canadian court will overlook this distinction between a prohibition and a restriction. However, this requires a "creative" favourable interpretation that cannot be guaranteed.

Third and last, a cheque payable to the payee's order (and thus not governed by BEA s. 20(1)) may be restrictively endorsed by the payee. Thus, under BEA s. 67,

(1) An endorsement may contain terms making it restrictive.

(2) An endorsement is restrictive that prohibits the further negotiation of the bill, or that expresses that it is a mere authority to deal with the bill as thereby directed, and not a transfer of the ownership thereof, as, for example, if a bill is endorsed "Pay . . . only", or "Pay . . . for the account of . . .", or "Pay . . ., or order, for collection".

(3) A restrictive endorsement gives the endorsee the right to receive payment of the bill and to sue any party thereto that his endorser could have sued, but gives him no power to transfer his rights as endorsee unless it expressly authorizes him to do so.

⁴⁶ *National Bank v. Silke*, [1891] 1 Q.B. 435 (Eng. Q.B.).

⁴⁷ Chalmers and Guest, *supra* note 45 at §2-061. See also Crawford, *supra* note 17 at §22:20.80(1).

⁴⁸ Crawford, *ibid.*

⁴⁹ It was held in England that a bill of exchange drawn "to the order of . . . only" and crossed "Not Negotiable" is covered by that provision: *Hibernian Bank v. Gysin*, [1938] 2 K.B. 384; aff'd [1939] 1 K.B. 483. Also an instrument either marked "not transferrable" or payable to "X only" (Crawford, *supra* note 17 at §22:20.80(1)), or possibly even to "X only or order" (Chalmers and Guest, *supra* note 45 at §2-061), will fall into the ambit of the provision.

⁵⁰ For the possibility that the prohibition may be broader so as to cover also the transfer to a depositary bank for collection see Crawford, *supra* note 17 at §22:20.80(1).

(4) Where a restrictive endorsement authorizes further transfer, all subsequent endorsees take the bill with the same rights and subject to the same liabilities as the first endorsee under the restrictive endorsement.

Under BEA s. 68,

Where a bill is negotiable in its origin, it continues to be negotiable until it has been

(a) restrictively endorsed

Accordingly, a CCS may not become a HDC of a restrictively endorsed cheque e.g. "for collection" or "for deposit". However, restrictive endorsement requires the depositor's endorsement signature which will make the solution imperfect for the electronic deposit. Moreover, to prevent multiple electronic deposits to more than one bank, a depositary bank may insist that its name will be written above the endorsement signature — so as to preclude a subsequent conflicting endorsement to another bank.

Regardless of the method in which negotiability is restricted, it is in the depositary bank's interest to benefit from it and be a HDC under BEA s. 165(3). Thereunder,

Where a cheque is delivered to a bank for deposit to the credit of a person and the bank credits him with the amount of the cheque, the bank acquires all the rights and powers of a holder in due course of the cheque.

Will BEA s. 165(3) confer on a depositary bank a HDC status on a cheque whose negotiability was restricted and that was received by it for deposit electronically? First, to bring the depositary bank into the ambit of the provision, a court must read "delivered" as including electronically transmitted. Even without physical delivery, due to the statutory equation between the official image and the paper cheque under BEA s. 163.2,⁵¹ this interpretation is not impossible. Second, the principal question is however whether BEA s. 165(3) applies to a cheque of which negotiability has been restricted. A positive answer is given in connection with the third option under which a cheque is restrictively endorsed such as "for collection."⁵² The answer is less clear for crossed non-negotiable as well as non-transferable cheques discussed above in this part. Literally read, BEA s. 165(3) applies to all types of cheques, including crossed non-negotiable and marked non-transferable. However, presumably, in passing BEA s. 165(3), the Legislature did not take into account both practices.

4. CONCLUSION

The intensification of the cheque electrification process means that the news on the death of the paper cheque are exaggerated. Indeed, in undertaking the image rule project, the CPA responded to genuine business demands. For sure, in completing the project by providing for common standards and rules for the implementation of the BEA official image and electronic presentment provisions, set out in Part 2 above, the CPA promoted "the efficiency, safety and soundness of its clear-

⁵¹ BEA, *supra* note 1, s. 163.2 states that: "An official image of an eligible bill may be dealt with and used for all purposes as though it were the eligible bill."

⁵² See e.g. Crawford, *supra* note 17 at §25:30.30(2).

ing and settlement systems and [took] into account the interests of users" so as to fulfill its duty under s. 5(2) of the CP Act.⁵³

Particularly, the BEA Electronic Presentment provisions made an inroad into the physical delivery requirements as to cheques. These provisions allow for the presentment of a cheque image and a replacement document. They further facilitated the practice of an electronic deposit.

At the same time, the electronic deposit practice gives rise to an abuse risk against which cheque law, having been focused on the paper instrument, has not caught up yet. The risk can be reduced but the effectiveness of possible risk reduction measures cannot be confidently predicted. Certainty requires that the BEA Electronic Presentment provisions as implemented by the image rule project will lead to further work designed to address the rights and risks of participants.

Indeed, an environment in which one set of rights and duties is embodied in original paper, its copy/ies, and its electronic image, all of which co-exist, albeit not necessarily in the same hands, is quite unsafe. It is bound to create an "explosive" mixture leading to conflicting legitimate expectations. Resolution is however not impossible and yet requires an intensive expert work. Without guidance from Parliament and regulators outstanding issues are unlikely to be satisfactory settled by courts on a case by case basis.

A follow-up project is thus needed. Certainly, it is feasible. At the same time, critiques may lament that nobody is charged anymore with the mandate "to plan the evolution of the national payments system" as the CPA once was.⁵⁴ Critiques are likely to suggest that the energy spent on extending the life of the cheque may be better used to develop a fully electronic alternative.⁵⁵ Only time will tell if the survival of the cheque in a mixed paper/electronic environment is truly a step forward. For now we have to live with this environment. Lawyers and judges are to become aware of the entire implications of this stage in the evolution of the cheque — to which this commentary purported to alert.

⁵³ *Supra* note 1.

⁵⁴ *Canadian Payments Association Act*, R.S.C. 1985, c. C-21, s. 5(2) (superseded by CP Act, *ibid.* which does not include this provision).

⁵⁵ A most comprehensive call for transition to digital payment methods is that of The Task Force for the Payments System Review (Department of Finance, Canada). The Final Report, *Moving Canada into the Digital Age* was submitted in December 2011 and released by the Minister of Finance (Canada) on March 23, 2012. It is available online at: <<http://paymentssystemreview.ca/index.php/papers/moving-canada-into-the-digital-age/index.html>>.